

# PROGRAM TO MODERNIZE THE MANAGEMENT OF WATER AND SEWERAGE SERVICES

(NI-0097)

## EXECUTIVE SUMMARY

<b>Borrower:</b>	Republic of Nicaragua.	
<b>Executing agency:</b>	Empresa Nicaragüense de Acueductos y Alcantarillados (ENACAL).	
<b>Amount and source:</b>	IDB (FSO):	US\$13,900,000
	Cofinancing (OPEC):	US\$ 5,000,000
	Local:	US\$ 2,100,000
	Total:	<b>US\$21,000,000</b>
<b>Financial terms and conditions:</b>	Amortization period:	40 years
	Disbursement period:	5 years
	Interest rate:	1% first 10 years
		2% thereafter
	Inspection and supervision:	1%
	Credit fee:	0.5%
	Currency:	U.S. dollar
<b>Objectives:</b>	<p>The main objective of the program is to help consolidate water supply and sewerage service reform through an operation specifically designed for the operator ENACAL.</p> <p>The specific objectives of the program are: (i) to support short-term modernization of ENACAL, giving priority to activities for the improvement of operational efficiency through a business strengthening program; (ii) to implement a coherent strategy for greater private-sector participation in the provision of services; and (iii) to help resolve problems associated with providing water supply and sewerage services in poor, illegally settled areas of Managua (marginal settlements).</p>	
<b>Description:</b>	<p>In pursuit of the proposed objectives, the program consists of two subprograms: (i) business strengthening through a service/management contract with an international operator; and (ii) a pilot project to improve and expand services in the marginal settlements of Managua through water supply and sewerage connection works.</p>	

## **1. Subprogram 1: Business strengthening (US\$13.5 million)**

The aim of this subprogram is to modernize service management by means of contracts with an international operator, including: (i) a service component to execute a business strengthening program at the national level; and (ii) a delegated management component in one region of the country.

The service component (US\$8 million, with a duration of three years) would cover the following activities: (i) full renovation of computer systems; (ii) a plan to reduce the volume of unmetered water; and (iii) additional technical advisory services.

The delegated management component would delegate the management of water supply and sewerage systems in the León and Chinandega regions (population 400,000) to a private operator for a period of five years. This component would be essentially self-financing, with the operation providing start-up support during the first three years, covering part of the operator's fees and modernization costs (US\$4 million).

The strengthening program also includes various consultancies and technical assistance operations (US\$1.5 million). Support will be provided in connection with execution of the service/management contract with the international operator from: (i) a firm specialized in the processes of private sector participation to conduct the bidding and contract award process; (ii) program audits to monitor contract performance by both parties; and (iii) quarterly financial reviews of ENACAL accounts. In addition, the program will finance two technical assistance operations for modernization of the sector: (i) a consultancy to support the transformation of ENACAL into a publicly-held corporation; and (ii) preparation, under the responsibility of the regulatory agency INAA, of a master plan for development of the sector.

## **2. Subprogram 2: Water supply and sewerage connections in settlements (US\$6 million)**

This subprogram consists of a pilot project to rehabilitate and regularize water supply and sewerage service in settlements with an estimated total of 4,000 households.

The program would finance the connection works on a multiple-works basis (US\$5 million) and would include a component for public education and promotion campaigns and microfinancing for household facilities (US\$1 million).

**Environmental and social review:**

The program is considered viable from an environmental point of view in that the activities proposed would have a positive environmental impact.

For the component concerning connection works in marginal settlements, the mitigation measures recommended for the NI-0027 program (approved in 1996) will be applied to sewerage expansion works. In particular, before entering into a contract for the construction works, ENACAL must provide evidence that the bidding specifications include the environmental requirements recommended in a Bank-approved environmental impact assessment (EIA) of the project.

**Benefits:**

By involving an international operator, the business strengthening subprogram will permit short-term improvements in ENACAL's financial situation and operations, facilitating the application of sector reforms. It will also permit the formulation of a coherent medium-term strategy for greater private-sector participation.

The subprogram for connections in marginal settlements will help to improve water supply and sewerage services for approximately 4,000 low-income households, and will serve to test a pilot execution mechanism for possible replication.

**Risks:**

A lack of interest among operators could preclude the signature of a contract (or increase its cost). Institutional weaknesses within the counterpart agency (or political interference) could limit the impact of the business strengthening program. *Mitigation:* selection of a major operator with extensive experience in developing countries is essential to the program's success. Various aspects of the service/management contract are designed to be attractive to private operators: (i) limited economic risk; (ii) the combination of service activities with management delegation; (iii) provisions for consultation with key stakeholders to finalize the specifications; and (iv) a strategic platform for possible privatization in the future.

Conflicts with the operator over contract execution could affect the viability of the strategy for greater private sector participation in service delivery over the medium term. *Mitigation:* the contractual documents will be prepared jointly by four consultancies. The contract will be monitored independently through a program audit, which could facilitate arbitration.

Another risk is local resistance to the marginal settlement connection works. *Mitigation:* the program is structured around education and promotion campaigns, with individual financing for household systems, which should facilitate community support. A mechanism tried and tested in the field for a similar ENACAL program, with

European cooperation, will be used. The modest size of this pilot project (4,000 households), will make it possible to concentrate on neighborhoods where community support is greatest.

**The Bank's  
country and  
sector strategy:**

The program is consistent with the strategy outlined in the country paper, and in particular: (i) support for the State reform process; (ii) the promotion of private-sector participation; (iii) poverty reduction and the inclusion of disadvantaged population segments; and (iv) preservation of the environment.

**Special  
contractual  
clauses:**

Prior to the first disbursement of resources, ENACAL must present evidence, to the satisfaction of the Bank, that: (i) a funds-transfer agreement has been signed with the borrower; (ii) the customer rate adjustment plan established by INAA resolution 002 of June 26, 1999 has been applied; and (iii) a contract has been signed with an external financial auditing firm for preparation of the quarterly review of ENACAL accounts (paragraph 4.23).

Once the general conditions established in paragraphs (a), (b), (e), and (f) of Article 4.01 of the General Norms have been fulfilled and the funds-transfer agreement between the borrower and ENACAL has been presented, the Bank may disburse up to US\$250,000 to enable ENACAL to fulfill the conditions precedent (paragraph 4.24).

For the disbursement of resources in excess of US\$600,000 under the business strengthening subprogram, ENACAL must present evidence that a service/management contract has been signed with a private operator and that an auditing firm has been hired to monitor that contract (paragraph 4.25).

To be eligible for an initial disbursement of US\$300,000 for the marginal settlements connection subprogram, ENACAL must present evidence that a loan agreement has been concluded with OPEC for the co-financing of the works. For disbursements beyond this amount, ENACAL must present: (i) evidence that a specialized consulting firm has been hired to administer the microloans and promotion component; and (ii) the credit regulations under which micro-loans will be provided to users, subject to prior Bank approval (paragraph 4.26).

**Conditions with respect to execution**

The borrower must fulfill the following conditions during execution of the program: (i) the management/service contract with the private operator must be executed in accordance with the terms established therein; (ii) the rates must be applied in accordance with INAA decree 45 of June 23, 1998, and resolution 001 of August 7, 1998; and (iii) ENACAL must remain, at a minimum, within the following parameters: no more than 6.5 employees per 1,000 water supply connections; and a collection rate no lower than 85% (paragraph 4.27).

**Poverty-targeting and social sector classification:**

This operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704, paragraph 3.3).

**Procurement:**

International public bidding procedures will be used, in all cases where Bank financing resources are required, for works contracts in excess of US\$1 million and goods and service contracts in excess of US\$150,000.

**Exceptions to Bank policy:**

An exception to Bank procurement policy (GS-206) is being requested to authorize separate bidding on the international operator contract by firms related by way of commonly held stock, provided that: (i) the participation of one of the bidding firms in another does not represent a controlling interest; (ii) one of the related firms does not have operational control over another by virtue of a shareholders agreement or other means and has not effectively delegated its management to a common third party. This exception is justified by the highly concentrated structure of the international water supply sector and the need to increase competition among firms for this contract as much as possible.

A second exception is also requested to permit the operator selected to participate without limitation in future bidding processes for the operation of water supply and sewerage services in the country. This exception is necessary to make the contract attractive to major international operators and ensure the greatest possible competition among bidders.